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Timber Capital Gains — The Option Rule of Section 631(b)

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In 1943 Congress enacted the predecessor of section 631 of the Internal Revenue Code,[1] section 117(k),[2] with the intention of bestowing upon timber owners capital gains treatment for income derived from the disposition and severance of timber.[3] The legislation was novel in that it provided for preferential treatment regardless of whether the timber was cut for sale or for use in the taxpayer's trade or business[4] or was held by the taxpayer primarily for sale to customers in the ordinary course of trade or business.[5] Under section 631(a), a timber owner or one possessing a cutting contract may elect to treat the cutting of timber as a sale or exchange, thereby qualifying for capital gains treatment the difference between the timber's fair market value and the adjusted basis for depletion purposes.[6] Section 631(b) qualifies for capital gains treatment income derived from the disposition of timber by an owner who thereafter retains an economic interest in the timber.[7]

Substantial litigation has occurred concerning the applicability of section 631(b) to timber cutting options. The most recent deci-

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1. I.R.C. § 631, S. Rep. No. 627, 78th Cong., 1st Sess. 25-6 (1943); see I.R.C. §1231. All statutory references are to the Internal Revenue Code unless otherwise indicated.

2. Int. Rev. Code of 1939, ch. 1, § 117(k), 58 Stat. 46.

3. Section 117(k) of the 1939 Internal Revenue Code and § 631 of the 1954 Internal Revenue Code are virtually identical in their treatment of timber capital gains and will be used interchangeably throughout this Article. See note 19 *infra*.

Subsection (c) of section 631 provides roughly equivalent preferential treatment for coal or domestic iron ore mined in the United States as subsection (b) provides for timber. The operation of section 631(c) is beyond the scope of this Article.

5. Treas. Reg. § 1.631-2(a)(1) (1960).

4. Under normal circumstances, I.R.C. § 1221(1) would preclude such treatment.

7. I.R.C. § 631(b); *see* Treas. Reg. § 1.631-2(a)(1)-(2) (1960); I.R.C. § 1231.

6. I.R.C. § 631(a); *see* Treas. Reg. § 1.631-1(a)(1) (1960).

sion, *Forbes v. United States*,[8] reaffirmed a lengthy procession of precedents originating in the Court of Appeals for the Ninth Circuit,[9] holding that such agreements do not satisfy the disposal requirements of section 631(b). The cutting option issue is of significant concern to timber owners because such agreements are often utilized in the timber industry.

Under the typical timber cutting option, the selling taxpayer enters into one of two alternative agreements with the purchaser. Under one alternative, similar to the one involved in *Forbes*, the timber owner grants the purchaser the right to cut and remove as much of the timber located on the seller's lands as the purchaser desires. The purchase price is usually a specified amount per thousand board feet of timber, possibly adjusted for the quality or type of timber sold. The other alternative specifies and describes the timber to be cut, the price at which such timber is to be purchased, the workmanship standards and obligations to be followed in the cutting and purchasing operations, and the payment dates for timber purchased. This type of agreement, however, contains termination provisions exercisable by either party upon a specified number of days notice. Such agreements do not represent traditional option contracts in which consideration, usually in the form of money, is given by one party in order to obtain from a second party an offer irrevocable for a stated period of time.[10] In the present context, the timber cutting agreements of the type referred to in *Forbes* are described as options because the timber purchaser is free to exercise to any extent the cutting rights obtained from the timber owner in return for a promise to pay a designated amount for any timber that is cut.[11]

The selling taxpayer under an option agreement would prefer to report the gain on the disposition of the timber as capital gains, pursuant to section 631(b), rather than as ordinary income. Such treatment is authorized under section 631(b), which provides as follows:

> In the case of the disposal of timber held for more than 12 months before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner retains an economic interest in such timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion

8. 75-1 U.S. Tax Cases ¶ 9126 (E.D. Tenn. 1974).

9. *E.g.*, Jantzer v. Commissioner, 284 F.2d 348 (9th Cir. 1960); Ah Pah Redwood Co. v. Commissioner, 251 F.2d 163 (9th Cir. 1957).

10. *See* 1A A. CORBIN, CONTRACTS § 263 (1963).

11. *Compare* Grover B. Kelsay, 31 T.C.M. (CCH) 1232 (1972) *with* 1A A. CORBIN, CONTRACTS § 259 (1963).

> basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber.[12]

Capital gains benefits are thus available if the taxpayer meets a four-fold test; the taxpayer must (1) be the owner of the timber, (2) dispose of it under any form of contract, (3) have held the timber for the requisite holding period,[13] and (4) retain an economic interest in the timber to be severed.

The first requirement is met in an option transaction if the selling taxpayer owns the timberlands from which the timber is to be cut and sold. Compliance with the holding period requirement in such a situation is easily determined; it begins on the date of acquisition of the timber and ends on the cutting date. The retained economic interest requirement is satisfied if the purchase price is solely contingent upon severance of the timber and is payable at a specified price per thousand board feet.[14] The remaining issue for section 631(b) qualification, therefore, is whether a suitable disposal has been effectuated by the timber owner. The Internal Revenue Service, pursuant to judicial authority, contends that no disposal actually occurs in an option transaction when the agreement is made because the purported purchaser either is not bound to cut and purchase any particular amount of timber or, by virtue of the termination provisions, may avoid any such obligation. The disposal occurs upon severance of the timber at which time, however, no economic interest is retained by the seller.[15]

This Article will review the case law dealing with the application of section 631(b) to timber cutting options, the legislative history and tax policy of section 631(b), and the judicial attitude regarding such agreements prior to the enactment of section 631. This material supports the conclusion that the courts, and consequently the Service, have been unduly restrictive in interpreting the disposal requirement of section 631(b). Option agreements meet the requirements of that

12. I.R.C. § 631(b).

13. Under prior law the holding period was 6 months; however, the 1976 Tax Reform Act increased the holding period to 9 months for the year 1977, and to one year for the year 1978 and thereafter. Pub. L. 94-455 § 1402(b)(2).

14. Treas. Reg. § 1.611-1(b) (1954); Dyal v. United States, 342 F.2d 248 (5th Cir. 1965).

15. *See* Jantzer v. Commissioner, 284 F.2d 348 (9th Cir. 1960); Ah Pah Redwood Co. v. Commissioner, 251 F.2d 163 (9th Cir. 1957). It should be noted that the parties' activities prior to entering into an apparent option agreement may give rise to the argument that an enforceable binding contract exists, notwithstanding the option language, once the facts and circumstances are analyzed. For purposes of this Article, however, it is assumed that this cannot be shown.

section, and gains derived from such disposals of timber should receive capital gains treatment, provided the other requisites of section 631(b) are met.

Ah Pah Redwood v. Commissioner: The Ninth Circuit's Error

The decision of the Ninth Circuit Court of Appeals in *Ah Pah Redwood Co. v. Commissioner*[16] defined the disposal requirement of section 631(b) as requiring a binding bilateral contractual arrangement between the parties in a timber cutting contract.[17] As a consequence of that definition, timber cutting options have not been included within the class of transactions that receive preferential tax treatment pursuant to section 631(b).

In *Ah Pah Redwood,* the taxpayer purchased timberlands in October 1947 and shortly thereafter authorized an affiliate, Coast Redwood Co., to commence cutting timber for a sales price of five dollars per thousand board feet of timber as removed. Coast began its cutting operations in 1947 and continued its activities until January 1950, paying the Ah Pah Redwood Company the agreed price for the cut timber. The taxpayer, Ah Pah Redwood Company, in its returns for 1948 and 1949, claimed all monies received from Coast after April of 1948, six months after it acquired its interest in the timberlands, as long term capital gains under section 117(k)(2), the predecessor of section 631(b). The Service took the position that the receipts from Coast were ordinary income rather than capital gains and assessed a deficiency against the Ah Pah Redwood Company. The Tax Court agreed with the Service.[18]

On appeal to the Ninth Circuit, Ah Pah Redwood Company argued that the necessary disposal of its timber did not occur at the time it entered into the agreement with Coast but rather that it occurred at the time the timber was cut and purchased. It was apparently forced to adopt this position because, at the time of the agreement, it had not owned the timberland for more than six months, and consequently, could not otherwise comply with the statutory holding period.[19] Ah Pah Redwood Co. characterized the agreement as a license to cut timber coupled with an offer to sell any timber that

16. 251 F.2d 163 (9th Cir. 1957).

17. *Id.* at 167.

18. Ah Pah Redwood Co., 26 U.S. Tax Cas. 1197 (1956).

19. 251 F.2d at 165-66. Subsequently, the section was amended by Congress to provide that "the date of disposal of such timber shall be deemed to be the date such timber is cut" instead of the earlier contract date. I.R.C. § 631(b).

was cut. It claimed that such an agreement was not a contract because it was unsupported by consideration and, therefore, could not satisfy the contract requirement of section 117(k)(2). Alternatively, the company argued that, even if the agreement were a contract, it was subject to revocation and, consequently, did not constitute a disposal of the timber at the time it was made.[20] The Service, on the other hand, took the position that the 1949 agreement between the company and Coast represented a disposal of the timber at the time it was made, thus disabling the company's claimed tax preference for failure to meet the necessary statutory holding period.[21]

The Ninth Circuit agreed with the taxpayer, finding that no disposal occurred at the time the agreement was entered into. It concluded that, for the purposes of section 117(k)(2), the necessary disposal of timber occurred at the time both parties incurred a binding obligation under the agreement:

> [T]he stipulated facts concerning the arrangement between petitioner and Coast . . . indicate that no contract was entered into in October, 1947. Under that arrangement, petitioner "allowed" Coast to "start cutting timber" and "pay $5.00 per thousand feet as removed." Coast was under no obligation to remove any timber, and accepted no risk with respect to timber not removed. Petitioner received no consideration in any form at the time of the October, 1947 arrangement. . . . [It] was not a "disposal," within the meaning of subsection (k)(2), and does not stand in the way of characterizing the later cutting and payment transactions as such "disposals."[22]

Despite the court's agreement with the taxpayer on the nature of the disposal requirement of section 117(k)(2), however, it determined that the retained economic interest requirement of section 117(k)(2) had not been met; under the company's characterization of its transactions with Coast, the sale and payment had occurred at the same time.[23]

Thus, the doctrine of *Ah Pah Redwood* was premised upon the taxpayer's argument that the disposal did not occur upon the making of a cutting option agreement between a timber owner and purchaser. Subsequent decisions have followed the *Ah Pah Redwood* rationale

20. 251 F.2d at 166.

21. *Id.* at 167.

22. *Id.*

23. The court stated, "We also hold, however, that these later cutting and payment transactions, which occurred between April 1948 and the end of 1949, were not within subsection (k)(2), because they did not represent disposals in connection with which the owner retained an economic interest in such timber." *Id.*

without further analysis of the issue.[24] The subsequent cases have never evaluated the holding of *Ah Pah Redwood* from the standpoint of policy, legislative history, or established precedent.

A few observations concerning the *Ah Pah Redwood* decision should be noted. The Ninth Circuit, in defining a timber disposal, cited no authority for its position. There was no discussion of previous decisions involving section 117(k)(2) or of the law preceding its enactment, and, more importantly, no analysis of the section's legislative history or leading commentators' explanation of its operation.[25]

Ample authority, ignored by the Ninth Circuit, mandates a different result in cases concerning timber cutting options. The various grounds upon which the decision in *Ah Pah Redwood* can be faulted are discussed below.

Erroneous Interpretation of the Term Disposal as a Modifier of the Term Contract

Much of the Ninth Circuit's position regarding the application of section 117(k) and, thus, section 631(b) to option agreements is premised upon a close definitional relationship between the term disposal and the statutory phrase "any form or type of contract."[26] Instead of recognizing a unilateral agreement or a licensing agreement as fulfilling the contract requirement, the court in *Ah Pah Redwood* concluded that the term disposal was an important modifier which required a transaction from which neither party could withdraw. The legislative history and subsequent judicial interpretations of section 631(b), however, demonstrate that the term disposal was not intended to modify or amplify the "any form of contract" re-

24. Jantzer v. Commissioner, 284 F.2d 348 (9th Cir. 1960); Forbes v. United States, 75-1 U.S. Tax Cases ¶ 9126 (E.D. Tenn. 1974).

Typical of subsequent decisions is the Tax Court opinion in *George L. Jantzer* stating: "The oral arrangement between the partnership and the corporation could be terminated at will and the corporation accepted no risk, gave no consideration and was under no obligation to cut any amount of timber. Thus the arrangement was not a contractual disposal of the Onn timber but was in the nature of a continuing offer to sell, which offer was accepted by the corporation with respect to each tree through the corporation's act of cutting, manufacturing, and paying for that tree." 32 T.C. 161, 172 (1959), *aff'd,* 284 F.2d 348 (9th Cir. 1960).

25. *See* Briggs & Condrell, *Tax Treatment of Timber,* 5 TIMBER TAX J. 1, 54 (1969).

26. Section 631(b) begins: "In the case of the disposal of timber held for more than . . . months . . . by the owner thereof under any form or type of contract by virtue of which such owner retains an economic interest in such timber . . . ."

quirement but instead was intended to limit the types of forestry activity to which the benefits of section 631(b) were to be extended.

In *United States v. Brown Wood Preserving Company*,[27] the Court of Appeals for the Sixth Circuit indicated that the term "disposal of timber" was used to clarify the fact that timber, not timber products such as turpentine or parts of felled timber, qualified for preferential treatment under section 117(k)(2). The court, in denying application of section 117(k)(2) to the granting of rights to extract turpentine, stated: "[T]he phrase 'disposal of timber' ordinarily means a true disposal by means of severance of standing trees. . . . If Congress had intended to extend capital gains treatment to products derived from the sap of a standing tree, it would certainly have used more appropriate language than 'disposal of timber.'"[28] Thus, the term disposal was intended to modify the term timber and not the section's contractual requirement.

This interpretation comports with the Congressional policy underlying the enactment in 1943 of section 117(k) of encouraging the severance of timber to facilitate the war effort.[29] In addition, it is supported by the Service's approach in Revenue Ruling 56-434,[30] which held that section 631(b) is not applicable to a sale of felled limbs for pulpwood extraction.

As evidenced by the authority discussed above, the term "disposal" was intended only to modify the term timber and not to place a limitation on the type or form of contract between the parties involved in a timber transaction. Once a taxpayer enters into an option agreement for the cutting of standing timber, a disposal has been effected that satisfies the requirement of section 631(b).

License Agreements as Disposals

An additional shortcoming of *Ah Pah Redwood* and subsequent decisions is their inability to reconcile basic contract law with previous holdings that a timber license may constitute a disposal under section 631(b). The Tax Court, having determined that the term disposal modifies the term contract, concluded that in terms of tax law the concept of a disposal had traditionally been very broad and that

27. 275 F.2d 525 (6th Cir. 1960).
28. *Id.* at 529.
29. *Id.* at 527-28.
30. 1956-2 C.B. 334. *See also*, Lefevre, *Tax Aspects of Timber Transactions*, 18 N.Y.U. INST. FED. TAX 577, 585-87 (1960); Rev. Rul. 57-9, 1957-1 C.B. 265; Treas. Reg. § 1.631-2(e)(3) (1957).

Congress had intended to grant the benefits of section 631(b) to timber owners who disposed of their timber by means short of outright sale.[31] Timber licenses and timber cutting contracts, as well as outright sales, came within the disposal requirement of section 631(b).[32]

In the case law, the principal difference between a license and a cutting option is that under those agreements characterized as licenses there has been some expression of intent between the parties

31. Springfield Plywood Corp., 15 T.C. 697 (1950).

32. *Id.* at 702. The Senate Finance Committee stated that the use of cutting contracts gave rise to adverse tax consequences for the timber owner and that § 631(b) was intended to remedy this problem. "[O]wners who sell their timber on a so-called cutting contract under which the owner retains an economic interest in the property are held to have leased their property and are therefore not accorded under present law capital-gains treatment of any increase in value realized over the depletion basis. . . . If an owner of timber disposes of it under a contract by virtue of which he retains an economic interest in such timber, the amount received by such owner is to be treated in a similar manner [to § 117(k)(1) regarding election for capital gains treatment for cutting timber].

"This latter provision will afford relief to those who have leased their property under a contract whereby they retain an economic interest in the timber and are not entitled under the present law to capital gains treatment because of that fact." S. Rep. No. 627, 78th Cong., 1st Sess. 25-26 (1943).

The term cutting contract has frequently been defined. One early commentator noted a definition that identified a cutting contract with a license: "In essence, a timber-cutting contract (sometimes called 'timber lease') is merely a license granted by the owner of timber permitting the cutting of timber on his lands." Shatley, *Capital Gain Under Section 117(k)(1) of the Code*, 31 TAXES 132, 135 (1953). *See also* Lefevre, *supra* note 30 at 587-88.

One commentator, speaking of the application of section 117(k)(2) stated: "A common arrangement to which this subsection applies is the cutting contract under which the owner of the timber authorizes the vendee to go upon the lands of the owner, cut and remove certain timber, for which the owner is to be paid on a specified basis such as a fixed sum per thousand feet cut, with the owner retaining both title to the land and to the timber until cut. The subsection applies, however, no matter what the contractual arrangement, if the taxpayer has owned the timber for more than six months prior to the date of the contract and retains an economic interest in the timber . . . . " Hamilton, *Gain or Loss on the Cutting and Disposal of Timber*, 23 FLA. L.J. 307, 312 (1949).

Another commentator noted that "it is clear that the language of the statute is broad enough to cover a 'contract for sale' as well as a 'lease.' " His footnote regarding the term lease states: "A normal timber 'lease,' depending on its terms, may under state law be a license, a lease, or a contract for sale, but this is not determinative for tax purposes." Gambrell, *Income Taxation of Timber Transactions*, 20 GA. B.J. 172, 176 (1957). *See also*, Hamilton, *Gain or Loss on the Cutting and Disposal of Timber*, 23 FLA. L.J. 307, 312 (1949) in which the author concludes that the term lease as utilized by Congress was not intended to be limited in its definition by traditional property law but instead was intended to encompass any method of disposition regardless of state law characterization.

that the cutter will take all of the timber or all of a particular type of timber from the owner's land, but under the option agreement the purchaser does not necessarily manifest an intent at the outset to cut all the timber.[33] The obligations and duties of a party under a license, however, differ from those under a bilateral contract and more closely resemble those under a typical option agreement in that the purchaser is free to cut as much timber as seems desirable. In timber law, generally "a mere parole license to cut and remove timber is revocable at any time prior to its exercise to such extent as to confer upon the licensee a property right in the timber."[34] Thus, a license is terminable at will by either party. By definition, a licensing situation, like an option, imposes no *obligation of removal* on the licensee, and the licensee accepts no risk with respect to timber not removed.[35] As a consequence, a mere license could not fulfill the Ninth Circuit's requirements for capital gains treatment;[36] yet the section's legislative history and the case law[37] indicate that licenses were intended to be included in the methods of disposition allowed under section 631(b).

In *Ah Pah Redwood,* the Ninth Circuit attempted to distinguish earlier precedent allowing licensing arrangements under section 117(k)(2),[38] by holding that in order to qualify for the preferential tax treatment afforded by that section, any disposition must be contractual.[39] Such a requirement, however, ignores the fact that a license is readily distinguished from a bilateral contract by virtue of the permissive nature of a license.

To require bilaterial contractual disposal in order to meet the requirements of section 631(b) should disqualify licensing agreements; yet, earlier precedent accepted by the Ninth Circuit indicates that a license satisfies the disposal requirement of section 631(b)

33. *Compare* L. D. Wilson, 26 T.C. 474 (1956) *and* Springfield Plywood Corp., 15 T.C. 697 (1950) *and* Lowes Lumber Co., 19 T.C.M. (CCH) 727 (1960) *with* Jantzer v. Commissioner, 284 F.2d 348 (9th Cir. 1960) *and* Ah Pah Redwood Co. v. Commissioner, 251 F.2d 163 (9th Cir. 1957) *and* Forbes v. United States, 75-1 U.S. Tax Cases ¶ 9126 (E.D. Tenn. 1974).

34. 52 Am. Jur. 2d *Logs and Timber* § 59 (1970).

The conclusion that timber licenses are revocable at will has been firmly recognized by a number of jurisdictions. *See* Gerry v. Johnston, 85 Idaho 226, 378 P.2d 198 (1966). *Cf.* Rouse v. Roy L. Houck Sons' Corp., 249 Or. 655, 439 P.2d 856 (1968) (license for removal of rocks).

35. See note 32 *supra.*

36. Ah Pah Redwood Co. v. Commissioner, 251 F.2d 163, 167 (9th Cir. 1957).

37. Springfield Plywood Corp., 15 T.C. 697 (1950).

38. 251 F.2d at 167.

39. *Id.*

despite the underlying permissive nature of the license.[40] The Tax Court in *Springfield Plywood Corp.*[41] had considered the term "disposal" and concluded that Congress intended that the term include not only sales contracts but licensing arrangements as well. In that case, the taxpayer executed an agreement providing for the severance of timber within a stipulated time period. If the timber were not removed by that date, the purchaser was bound to pay for it without further rights thereto. The contract appeared to be a sales contract under Oregon law with a conditional time for removal; however, because the licensing agreement was entered into before the six month holding period for long term capital gain treatment was fulfilled, the taxpayer was compelled to argue that the transaction was merely a "license to cut"[42] and disposal occurred with the cutting of each tree. The court discussed the definition of "disposal" in the context of whether only a sale rather than a license was intended by Congress to fall within section 631(b). It concluded that the term "disposal" was sufficiently broad to include transactions other than sales, including leases and licensing agreements.[43] The court apparently found that a sale had occurred and thus a disposal existed under section 631(b) but held alternatively that, even had no sale occurred, a disposal would still exist because that term was intended to include licensing arrangements.[44]

Subsequently, the Tax Court in 1956 held that a timber purchase agreement, strikingly similar to the option situation in *Ah Pah Redwood*, complied with section 631(b)'s requirements. In *L. D.*

40. *See* Springfield Plywood Corp., 15 T.C. 697 (1950).

41. 15 T.C. 697 (1950).

42. *Id.* at 701.

43. The court stated: "[T]he statute requires, not sale, but 'disposal' of the timber, and that the terms 'disposal' or 'dispose of' are, on high authority, broader than 'sell.' In Phelps v. Harris, 101 U.S. 370, 380, we find 'The expression to dispose of is very broad, and signifies more than *to sell.* Selling is but one mode of disposing of property.' . . . In United States v. Gratiot, 39 U.S. 526, it was held that the power of Congress under Article 4, Section 3 of the Constitution to 'dispose of' public lands authorized leasing of lead mines thereon . . . . In Hill v. Sumner, 132 U.S. 118 . . . [t]he Court held that 'dispose of' is not synonymous with 'sell,' [and] looked to the purpose of the arrangement and contract . . . ." *Id.* at 701-02. *See also* Dayton Brass Castings Co. v. Gilligan, 267 Fed. 872 (1920); Koerner v. Wilkinson, 90 Mo. App. 510, 70 S.W. 509 (1902); Rider v. Cooney, 94 Mt. 295, 23 P.2d 261 (1932); St. Louis Trust Co. v. MacGovern & Co., 297 Mo. 527, 249 S.W. 68 (1923). The *Gratiot* decision specifically involved an option agreement.

44. 15 T.C. at 703. *See also* Boeing v. United States, 98 F. Supp. 581 (Ct. Cl. 1951) (leases); Gambrell, *Income Taxation of Timber Transactions*, 20 GA. B.J. 172 (1957).

Wilson,[45] the individual taxpayer formed a partnership with several other persons, and the partnership entered into a purchase agreement whereby it bought at a fixed price all the standing timber on a particular tract of land. Under Oregon law, this agreement granted the partnership equitable title to the timber before it was cut. The partnership later entered into an agreement with a corporation by which it transferred its cutting rights to the corporation. Under the agreement, the purchasing corporation was allowed to cut the timber at its option. No specific amount of timber was required to be cut or sold; the corporation could sever the timber as its needs arose. Notwithstanding these provisions and the fact that the corporation was under no obligation to remove any timber, the Tax Court concluded that the partnership had disposed of the timber in a manner that qualified under section 631(b).[46]

It is arguable that the Tax Court's conclusions would have been different had *Ah Pah Redwood* been decided at the time the Tax Court rendered its decision in *L. D. Wilson*. The Tax Court, however, maintained its position after *Ah Pah Redwood* in *Lowes Lumber Co.*,[47] distinguishing *Ah Pah Redwood* on its facts. The agreement in *Lowes Lumber Co.*, involved a licensing arrangement whereby the buyer was granted the right to enter the taxpayer's land and cut timber, paying for it on an as cut basis.[48] The court noted the Service's position that

> the timber cutting contracts were simply unilateral licenses to enter and cut the timber, which were not binding on either party, and hence, did not constitute a disposal of the timber at the time the contract was made, and consequently, the timber was not disposed of until a tree was cut and paid for, after which time the partnership retained no economic interest in the timber.[49]

Closely following its reasoning in *Springfield Plywood Corp.*, the court rejected this argument and concluded that the agreement constituted a bilateral sales contract. Even though the agreement was revocable, the taxpayer had presumably agreed to sell all the timber on its land, and by implication the purchaser agreed to buy all of it.[50] The court, however, did comment favorably on the *Wilson* case and concluded that even if the agreement constituted a licensing arrange-

45. 26 T.C. 474 (1956).
46. *Id.* at 481.
47. 19 T.C.M. (CCH) 727 (1960).
48. *Id.* at 730-31.
49. *Id.* at 738.
50. *Id.* at 738-39.

ment rather than a sale, Congress intended to extend the benefits of section 631(b) to such transactions.[51]

The Tax Court, therefore, maintains the position that section 631(b) is intended to apply to licensing situations. Timber licenses and options are similar legal agreements; no duty exists on the part of the party holding the license or option to exercise its right to cut any timber, but the party is bound to pay if and when it chooses to do so. Accordingly, because the timber owner in a licensing situation is entitled to report timber gains under section 631(b), the timber owner in an option situation is entitled to receive the same tax treatment. Although the Ninth Circuit concurred with the early decision of the Tax Court regarding licenses, it did not consider the option agreement in *Ah Pah Redwood* to be a suitable disposal of the timber. This position fails to recognize and account for the permissive nature of both a license and an option agreement.

Qualification of Timber Purchase Agreement for Section 631(a) Treatment Insures Qualification of Timber Sale Agreement for Section 631(b) Treatment

Another indication that the Ninth Circuit was in error regarding the qualification of timber cutting options for section 631(b) treatment is that such agreements have been held to bestow capital gains treatment upon the timber purchaser under section 631(a).[52] Sections 631(a) and 631(b) generally complement each other and allow a seller and a purchaser both to qualify for preferential treatment. If the purchasing taxpayer qualifies for capital gains advantages under section 631(a), the selling taxpayer in such a situation should qualify under section 631(b) for similar treatment.

Section 631(a) provides that a taxpayer may make an election to report a portion of the income from the cutting and sale of timber as capital gains if that taxpayer "owns, or has a contract right to cut, such timber (providing he has owned such timber or has held such contract right for a period of more than twelve months. . . .)"[53] This section and section 631(b) have a unique interrelationship. By virtue of the language, "has a contract right to cut," in section 631(a), Congress intended the timber purchasing taxpayer to be the logical contractual counterpart to the selling taxpayer subject to section

51. *Id.*

52. *See* United States v. Johnson, 257 F.2d 530 (9th Cir. 1958); Grover B. Kelsay, 31 T.C.M. (CCH) 1232 (1972).

53. I.R.C. § 631(a).

631(b) treatment. Commentators and courts have described this interrelationship as a double capital gains benefit.[54]

The use in section 631(a) of the term "contract right," and section 631(b)'s language, "disposal . . . under any form or type of contract," indicate that both parties to a timber transaction may qualify for capital gains treatment, subject to three limitations. First, the taxpayer with a contract right to cut timber must, at the time of severance, possess a proprietary interest in the timber. Second, the section 631(b) taxpayer must retain an economic interest in the timber and be entitled to payments conditioned on severance of the trees. Third, each taxpayer must meet the requisite holding period established in both sections. Where these requirements are met by both parties, the qualification by one party for section 631(a) or (b) treatment should automatically ensure qualification of the other for similar treatment.[55]

Both subsections employ the term "contract," and logical interpretation of that term requires that it be defined similarly for sections 631(a) and (b). Case law and Treasury regulations state that a contract right to cut timber requires that the taxpayer "must have a right to sell the timber cut under the contract on his own account or to use such cut timber in his trade or business."[56] The taxpayer must not only have a contract right to cut the timber, essentially a proprietary interest, but must have held this right for the requisite holding period.[57] In order to acquire and hold a contract right for the requisite period, the agreement must have been validly executed, and the proper period must have elapsed before the severance of any timber. The conclusion mandated by utilizing the Ninth Circuit's rationale that in option situations the agreement between the parties is merely a continuing offer to sell is that the purchaser could not hold a contract right to cut any timber. Consequently, the seller's failure to meet the requirements of section 631(b) by failing to dispose of the timber by contract should equally doom the purchaser's section 631(a) election; the purchaser also does not possess any contract right for the required holding period.

54. *See* Lowes Lumber Co., 19 T.C.M. (CCH) 727 (1960); Hamilton, *Gain or Loss on the Cutting and Disposal of Timber*, 23 FLA. L.J. 307 (1949); Liles, *Federal Income Tax Treatment of Timber Transactions Under Sections § 631(a) and (b) of the Internal Revenue Code*, 2 ABA BULL. SECTION TAX. 47, 49 (1968).

55. *See* Little, *Federal Income Taxation of Timber*, 40 MISS. L.J. 217, 226 (1969).

56. Treas. Reg. § 1.631-1(b)(1); Helga Carlen, 20 T.C. 573, 577 (1953), *aff'd*, 220 F.2d 338 (9th Cir. 1955).

57. I.R.C. § 631(a).

Case law, however, has held that contracts virtually identical with timber cutting options qualify under section 631(a).[58] In *United States v. Johnson*,[59] the Ninth Circuit considered a timber purchaser's assertion of entitlement to capital gains treatment under the predecessor of section 631(a). The transaction resembled an option situation; the agreement was a license subject to termination provisions that ran in favor of the licensor. In contrast to the typical option situation, the taxpayers in *Johnson* were expected to log the timber before a certain date.[60] Under the *Ah Pah Redwood* rationale, the retention of the termination provision should have rendered the agreement merely a continuing offer to sell the timber. The *Johnson* court, however, concluded that the purchasing taxpayers were entitled to elect section 631(a) treatment because, in effect, they had held a contract right for the requisite time period.[61]

A similar conclusion was reached by the Tax Court in *Grover B. Kelsay*.[62] In *Kelsay*, the taxpayer was authorized to cut timber under an irrevocable option. The court, without any citation of case law, concluded that the requirements of section 631(a) had been met:

> A right to cut is nothing more than an "option." It implies no obligation on the part of the holder of such right. Section 631(a) does not require that the taxpayer seeking to claim benefits have a binding contract to cut timber which is in effect for a period of 6 months prior to the taxable year. All the statute requires is that the taxpayer have an enforceable right, exercisable at its option, to cut such timber.[63]

Thus, under the *Johnson* and *Kelsay* rationales, either a licensing or an option agreement to cut timber is sufficient to meet the requirements of section 631(a). The *Kelsay* case further indicates that the Service did not contest section 631(a)'s applicability to a pay-as-you-cut agreement that placed the taxpayer under no obligation to cut timber. While *Kelsay* involved an irrevocable agreement, its conclusion should be undisturbed even if it had been revocable because, prior to any revocation, the right to cut timber exists and this right is the sole requirement of section 631(a).

Because a unique relationship exists between section 631(a) and

58. United States v. Johnson, 257 F.2d 530 (9th Cir. 1958); Grover B. Kelsay, 31 T.C.M. (CCH) 1232 (1972). *See also* Rev. Rul. 74-529, 1974-2 C.B. 185.
59. 257 F.2d 530 (9th Cir. 1958).
60. *Id.* at 532.
61. *Id.* at 534.
62. 31 T.C.M. (CCH) 1232 (1972).
63. *Id.* at 1236.

section 631(b), a transaction that qualifies one party under one of these sections for capital gains treatment should likewise qualify the other party to the transaction for capital gains treatment under the other section. Courts have specifically held that a timber cutting option can meet section 631(a) requirements, and, therefore, a similar conclusion should be reached for option agreements under section 631(b).[64]

Legislative Intent and Public Policy

Hearings prior to the enactment of section 117(k)(2), the predecessor of section 631(b), illustrates the types of situations to which these sections were intended to apply. Testimony at these hearings indicates that the Ninth Circuit's interpretation, which requires a binding commitment to cut and purchase timber, is erroneous.

The House Ways and Means Committee in 1943 heard testimony from a representative of the Forest Industries Committee on Timber Valuation and Taxation who criticized the discrimination against the timber industry inherent in the existing system of taxation and proposed a remedy. The remedy proposed was essentially adopted by the Ways and Means Committee as its original proposal for sections 117(k)(1) and 117(k)(2). The proposal provided for the qualification of a broad range of transactions for capital gains treatment.[65] The representative stated as a principle of reform:

> [a] taxpayer, who has disposed of his timber through a so-called cutting contract or similar form of contract where legal title is retained by the vendor to secure the performance of such contract, should be entitled to treat any excess of the amount received for such timber over the cost or other basis thereof as a capital gain.[66]

64. In Timber Conservation Company v. United States, the court stated that "the tests of qualifying under one section by the purchaser and of qualifying under the other by the seller are so similar that cases under one section are valuable precedents in determining the law under the other, and this Court accepts them as such." 208 F. Supp. 626, 630 (D. Ore. 1962). *See also* Lowes Lumber Co., 19 T.C.M. (CCH) 727 (1960); Lefevre, *supra* note 30, at 583-84.

65. "In case of the disposal of timber by the owner thereof under any form or type of contract by virtue of which the owner retains an economic or investment interest in such timber, including but not limited to a cutting contract, *a contract construed as a lease or royalty contract,* or a contract under which legal title to such timber is retained in the owner to secure the performance thereof, then the difference between the amount received for such timber and the adjusted depletion basis thereof shall be considered as though it were gain or loss." *Hearings before House Committee on Ways and Means on Revenue Revision of 1943,* 78th Cong., 1st Sess. 795, 797 (1943) (emphasis added) (statement by Lovell H. Parker).

66. *Id.*

He intended that timber licenses and cutting options fall within this class of transactions that satisfy this principle.[67]

Congress in its final enactment of section 117(k)(2) used the terminology, "under any form or type of contract," which was most probably intended to cover those contracts referred to by the representative. Congress was attempting to implement an incentive provision which would grant economic benefits to timber owners. As noted by the Court of Claims, "The legislative history of 117(k) indicates that Congress' principal purpose was to afford relief to timber owners."[68] Thus to implement properly the legislative intent, the provisions of 117(k) and 631 should be liberally construed.

Most likely Congress intended to grant the benefits of section 631(b) to those kinds of business transactions that occur regularly in the forestry industry. The methods whereby timber owners sold their timber in the years immediately preceding the enactment of the legislation included both licensing and option agreements.[69] The assumption that Congress was trying to ensure that the mere retention

67. In addition to his testimony, the representative submitted a supplemental statement regarding timber tax reform and therein cited various examples of the application of the proposed section 117(k). His examples illustrate a licensing situation, an open ended agreement under which the purchaser is not obligated to cut a specific amount of timber. His example (c) provided: "Smith, by a contract made in 1940, has a right to cut and remove the timber from 2,000 acres of land owned by Jones. The contract provides that on the 10th of each month Smith is to pay Jones $4 per thousand for the logs scaled and removed during the previous month. During 1943 Smith removes 10,000,000 feet of logs. On January 1, 1943, the trees which produced the logs removed had a fair market value of $6 per thousand. Smith has realized a capital gain of $2 per thousand which is treated like the capital gain of $3 per thousand in example (a). Also, as in (a), the adjusted basis of $4 per thousand becomes $6 per thousand as of January 1, 1943, and there is no change in the adjusted basis for the timber not scaled and removed in 1943.

(e) Under the basis conditions described in example (c) Jones contracted to dispose of his timber to Smith at $4 per thousand. Jones, on January 1, 1943, had an adjusted basis for the timber removed by Smith in 1943 for $2 per thousand. Consequently, Jones has a capital gain of $2 per thousand and is accorded treatment under proposed section 117(k)(2); the $2 capital gain is taxed at not to exceed 25 percent. There is no change in the adjusted basis of the uncut timber owned by Jones and included in the Smith contract." *Id.* at 806.

Thus, the example cited qualifies as a typical option agreement. The disposal is piecemeal, occurring with the passage of time and the purchaser's efforts. No total amount of timber is required to be cut by the purchaser under the hypothetical agreement, and assumptively, the seller has the right to terminate the contract at will. The important indicia of disposal is severance and payment; a situation identical with licensing agreements.

68. Boeing v. United States, 98 F. Supp. 581, 584 (Ct. Cl. 1951). *See also* 90 CONG. REC. 1965 (1944) (statement by Sen. Alben Barkley).

69. *See* P. BUTTRICK, FOREST ECONOMIES AND FINANCE, 368-70 (1943).

of an economic interest in an agreement to dispose of one's timber was the determinative criteria for section 631(b) qualification, and not the extent of the contractual rights between the parties, is logical. Furthermore, section 631(b)'s complement, section 631(a), refers to the purchaser's right to cut timber rather than an obligation to do so. The Ninth Circuit and other courts have laid undue emphasis on the term "disposal" and have thus created legal precedent that does not conform to the intent of Congress.

Even if the legislative history and authorities did not mandate the conclusion that option agreements fulfill the requirements of section 631(b), in the absence of any negative language indicating an intention to exclude such agreements, no violation of public policy or legislative intent occurs by extending the benefits of section 631(b) to such arrangements.[70] Congress by the use of the term, "any form or type of contract," intended to allow timber owners the utmost flexibility in structuring their transactions. The method of disposition was immaterial so long as an economic interest was retained. Licensing and option agreements comport with this intent.

In the timber industry representative's testimony before the House Ways and Means Committee, five basic reasons for extending preferential treatment to the timber industry were stated; such treatment is justified for the following purposes:

> (1) in order to allow forest owners and operators to manage their properties according to sound business considerations instead of being governed by tax reasons; (2) in order to correct present serious tax discriminations; (3) in order to give a tax treatment suitable to the circumstances of the industry, which, without the possibility of insurance, must face serious physical and economic hazards over long periods of time; (4) in order to encourage the war effort and put the industry in a position where it can meet present needs and provide post-war employment; and (5) in order in the public interest to promote better protection of forests, and to encourage and expand the practice of forestry.[71]

None of these policy considerations is offended by extending the application of section 631(b) to an option agreement. To the contrary, an option agreement is consistent with these policies, especially the first and fifth. A selling taxpayer should be able to choose a

70. Fahey, *"Relief" Provisions in the Revenue Act of 1943*, 53 YALE L.J. 459 (1944); Boeing v. United States, 98 F. Supp. 581, 583-84 (Ct. Cl. 1951).

71. *Hearings before the House Committee on Ways and Means on Revenue Revision of 1943*, 78th Cong., 1st Sess. 795, 803 (1943). *See Hearings before Senate Committee on Finance on H.R. 3687*, 78th Cong., 1st Sess. 665 (1943) (statement by Lovell H. Parker).

licensing or option method of disposition if it best suits business needs.

Congress was also concerned with the development of sound forestry methods and conservation. Prior income tax law required that there be an outright sale of the land or timber before an owner could claim preferential tax treatment. This rule caused owners to lose control over their land. A timber cutting contract, on the other hand, provided a vehicle by which owners could retain control of their land.[72] Thus, the new section was intended to enable timber owners to exercise sound methods of land conservation[73] and forestry practice.[74]

Licensing and option agreements provide a method by which the disposing taxpayer may exercise sound business judgment while advancing conservation efforts and good forestry practice because the licensor has the ability to terminate the license if the timber cutter's practices conflict with the licensor's judgment on these issues.[75] Under no circumstances do option agreements violate the rationale behind section 631(b)'s enactment and, therefore, they should be considered as one of the types of transactions that come within its operation.

Tax Treatment of Timber Sales Prior to 1943

Consideration of the events that precipitated the enactment of

72. "Many forest landowners have for many years sold timber from their lands under cutting contracts, retaining their land together with more or less forest growth for future production of timber. The cutting contract is a tool of wise forest management which should not be driven from use by unsound provisions of tax law. The cutting contract is a fairer method of selling than the outright sale; it substitutes known quantities for estimates; it gives better control of cutting procedure — forestry. It helps the owner of forest property to continue to own and manage his land wisely in his own and the public interest." *Hearings before House Committee on Ways and Means on Revenue Revision of 1943*, 78th Cong., 1st Sess. 795, 804 (1943).

73. The Fifth Circuit stated "The purpose of the provision [Section 117(k)(2)/631(b)] was to promote conservation, and it should not be used as a means of penalizing the taxpayers." Dyal v. United States, 342 F.2d 248, 253 (5th Cir. 1965). *See* McHenry, Dowling & Miller, *Tax Problems Involved in Timber Leases*, 1 TIMBER TAX J. 1, 16 (1965). *See also* Union Bay-Camp Paper Corp. v. United States, 325 F.2d 730 (Ct. Cl. 1963); 90 CONG. REC. 1949-50 (1944) (remarks of Sens. Taft and George); Briggs & Condrell, *Tax Treatment of Timber*, 5 TIMBER TAX J. 1, 3 (1969).

74. In hearings before the Senate Finance Committee, timber industry spokesman Mr. Lovell Parker stated: "Indeed, good forest management will be strongly stimulated by such amendments and the long range plan of the forest industries to bring about the continuous productivity of the forests will be fulfilled." *Hearings before Senate Committee on Finance on H.R. 3687*, 78th Cong., 1st Sess. 664 (1943).

75. *See Hearings before House Committee on Ways and Means on Revenue Revision of 1943*, 78th Cong., 1st Sess. 795, 824 (1943) (comments of Mr. Reed).

section 117(k)(2) is necessary in order to understand the purpose that Congress sought to achieve by this action and, in turn, the conflict between that purpose and the Ninth Circuit's position that option agreements do not satisfy the requirements of section 631(b). Prior to 1943 the tax consequence of an outright sale of timber or timberland was determined under the capital gains rules of the predecessor of sections 1221 and 1222(3). If the taxpayer was a dealer engaged in the trade or business of selling timber, the timber did not constitute a capital asset as defined in section 1221(1) and, therefore, did not comply with the requirements of section 1222(3), granting capital gains tax rates. Such preferential rates were available if the taxpayer held the property in an investment capacity.[76]

A line of cases developed prior to 1943 that considered the timber owner's assertion that income received pursuant to a stumpage contract qualified for capital gains treatment. Under this type of contract, the owner retained the title to the timber until it was severed and removed and payment was made by the purchaser. Courts held that the income derived from such transactions qualified for capital gains treatment.[77] The contention of the Service in these cases was that stumpage contracts under state law constituted executory contracts with title passing as the timber was cut. Consequently, the transactions were not a single sale of an asset but instead numerous sales of timber which resulted in a taxpayer's engaging in the operation of a trade or business. The Fifth Circuit in *United States v. Robinson*[78] rejected this argument and viewed such a transaction practically and fairly as a single sale. In an alternative contention advanced by the Service in stumpage contract cases, the purchaser was classified as an agent of the taxpayer, and the customers of the purchaser were viewed as the taxpayer's customers. The Service argued that the selling taxpayer was not entitled to capital gains treatment because the seller was actually engaged in the business of selling timber. In *Estate of M. M. Stark*,[79] the court rejected this contention, finding that the purchaser of such timber was not the agent

76. *See* Whitaker, *Timber Industry Tax Problems Scope*, 1957 TULANE TAX INST. 104, 131-38; Bohannon, *Tax Treatment of Gains and Losses in Timber and Coal Transactions*, 27 GEO. WASH. L. REV. 37, 42-45 (1958-59).

77. United States v. Robinson, 129 F.2d 297 (5th Cir. 1942); Isaac S. Peebles, 5 T.C. 14 (1945); Camp. Mfg. Co., 3 T.C. 467 (1944); Estate of M. M. Stark, 45 B.T.A. 882 (1941); John W. Blodgett, 13 B.T.A. 1388 (1928).

78. 129 F.2d 297, 300 (5th Cir. 1942).

79. 45 B.T.A. 882 (1941).

of the vendor, and upheld the treatment of the transaction as the sale of capital assets.

These pre-1943 agreements, under which the seller was entitled to capital gains treatment of the income received, were similar to option agreements in that they granted the right to sever timber but imposed no obligation on the purchaser other than to remit the stumpage payment at the time the timber was cut. Under state law, title to the timber did not pass to the purchaser until the timber was severed[80] and the sale occurred at that time. The fact that the transaction involved only a single purchaser precluded a finding that the timber owner was engaged in the conduct of a trade or business.

In *Isaac S. Peebles,*[81] the Tax Court specifically held that a timber owner in a timber cutting option agreement was entitled to report the income received as capital gains. The agreement granted the buyer the right to cut timber for a specified period but did not obligate him to cut any particular amount. The agreement also was subject to termination upon sixty day notice by the timber owner. Thus, under pre-1943 law, an option agreement qualified the selling taxpayer's income for capital gains treatment.

The United States Supreme Court, in *Burnet v. Harmel,*[82] undercut this line of authority by holding that, regardless of the transaction's characterization under state law, an oil and gas lease did not constitute a sale by the landowner of the mineral content of the soil and that, therefore, income received pursuant to such a lease could not be considered as capital gains.[83] The Service in a subsequent ruling concluded that "parties entitled to share in oil or mineral extracted, or the gross proceeds therefrom (including the parties to a lease providing for royalty payments of stated amounts per unit mined), have economic interests in the oil or mineral in place."[84] An owner of such an interest "had not made a sale: (1) where the owner was entitled to be paid stated amount per unit mined or extracted. . . ."[85] The result was that in a lease transaction the income derived by way of rental payments was characterized as ordinary income.

The Service proceeded to apply this rationale to timber cutting

80. *See, e.g.,* Carrie Lutcher Brown, 26 B.T.A. 781 (1932), *aff'd,* 70 F.2d 806 (5th Cir. 1934). *See also* John W. Blodgett, 13 B.T.A. 1388 (1928).

81. 5 T.C. 14 (1945).

82. 287 U.S. 103 (1932).

83. *Id.* at 109-11.

84. 1941-1 C.B. 214, 219.

85. Briggs & Condrell, *supra* note 25, at 46. *See also* Whitaker, *supra* note 76, at 140-42.

contracts. It construed them as leases and denied to the timber owner capital gains treatment for the income received as a result of such a contract.[86]

The specter of ordinary income treatment for timber transactions prompted Congress to enact section 117(k)(2).[87] The Senate's report acknowledged the discrimination precipitated by the Service's construction of the concept of retained economic interest and proposed to amend the existing law to "afford relief to those who have leased their property under a contract whereby they retain an economic interest in the timber and are not entitled under the present law to capital gains treatment because of that fact."[88]

The cases before *Burnet* indicated that the time of actual passage of title to the timber from the seller to the purchaser was not relevant in determining the availability of capital gains treatment to the income received by the timber seller. In enacting section 117(k)(2), Congress intended to eliminate the problem created by the Supreme Court's holding in *Burnet*, which had the effect of denying capital gains advantages to timber owners who entered into agreements disposing of their timber but who retained an economic interest in it until the timber was cut. Capital gains treatment was denied because the Court held that no sale had occurred under such an agreement. Congress intended to ensure the elimination of previous controversies regarding retention of an economic interest. The Legislative history and various commentators have stated that the enactment of section 117(k)(2) was an affirmation of all pre-section 117(k) cases granting capital gains treatment of timber transactions.[89] Thus, the *Peebles* and *Robinson* fact patterns, specifically involving option agreements, were intended to qualify for preferential capital gains treatment under section 631(b).

The Ninth Circuit in *Ah Pah Redwood* refused to recognize that a disposal of timber, in contrast to a sale, had occurred when an option agreement was entered into between a timber owner and purchaser. The court instead characterized the agreement as a continuing offer to sell; disposal occurred at the time a tree was cut and, thus, the offer accepted. By so characterizing the transaction, the timber seller could not qualify for capital gains treatment under sec-

86. Bureau of Internal Revenue Field Proc. Memo No. 249, Feb. 17, 1943.

87. S. REP. No. 627, 78th Cong., 1st Sess. 25-26 (1943).

88. *Id.* at 26.

89. *See* Boeing v. United States, 98 F. Supp. 581 (Ct. Cl. 1951); Whitaker, *Timber Industry Tax Problems Scope*, 1957 TULANE TAX INST. 104.

tion 117(k)(2), or later section 631(b), because no economic interest had been retained by the seller after the disposal had occurred. This characterization conflicts with the Congressional purpose underlying section 117(k)(2) and section 631(b) because it equates the concept of disposal with the sale of the timber instead of recognizing that a disposal occurs when the option agreement is entered, notwithstanding the seller's retention of an interest in the timber until it is sold.

Conclusion

The Ninth Circuit in the *Ah Pah Redwood* decision erroneously concluded that section 631(b)'s preferential treatment is not available to a taxpayer when timber is disposed of under an option agreement. The court failed to analyze prior precedent, the section's legislative history, and sound policy considerations in reaching its conclusion. Subsequent decisions have repeated the mistake made in *Ah Pah Redwood.* The peculiar facts presented in that case may partially explain the court's error. In order to comply with the requirements of section 631(b), the taxpayer was forced to contend that no disposal of timber had occurred at the time the option agreement was entered. Since then, the statute has been changed so that, if the identical facts were to arise today, the taxpayer would not need to make this argument.

In enacting section 631(b), Congress indicated the broad scope of its intention by utilizing the term, "any form of contract." Any method of disposing of timber should satisfy the requirements of this section so long as the seller retains an economic interest in the timber until it is actually cut. Under an option agreement, a seller has been found to retain such an interest. Thus, the disposition of timber under an option agreement should qualify for capital gains treatment under section 631(b). Contrary precedent is in error and should be overruled.

[The table of contents below has been prepared to facilitate use of the following Note]

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